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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 16.

HENRY O. HALE AND ELIZABETH C. HALE,
Appellants,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW,
Appellee.

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

APPELLEE'S BRIEF AND ARGUMENT.

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THE OPINION BELOW.

The opinion below is not yet officially reported. It appears on page 7 of this Record and in 271 Northwestern Reporter 168.

STATEMENT OF THE CASE.

Sec. 1304 of the Code of Iowa 1907 provides:

"Sec. 1304. *Exemptions.* The following classes of property are not to be taxed:"

(Then follows seven paragraphs listing the exemptions.)

In 1909 the legislature by Chapter 81 of Session Laws of 1909 amended the statute by adding to ths list of exemptions, the following:

> "Municipal, school and drainage bonds or certificates hereafter issued."

This clause was later amended by adding thereto the phrase,

> "by any municipality, school district, drainage district or county within the State of Iowa." (R. 6.)

All of the municipal and school bonds owned by appellant were issued after the amendment of 1909.

The road bonds involved were issued under, and after the passage of, the Iowa Statute now known as Section 4753-a13 of the Code of 1935, which provides:

> "Bonds and Road Certificates (whether issued in anticipation of special assessments or in anticipation of annual allotments of the primary road fund) shall not be taxed." (R. 6.)

The $1,000.00 "Soldier's Bonus Bond" was issued by the State of Iowa pursuant to Chapter 332 of the acts of the 39th General Assembly, Sub-section 10, of which provides:

> "Exemptions. All payments and allowances made under this act shall be exempt from taxation * * * and all bonds issued hereunder shall be exempt from taxation." (R. 6 and 7.)

Chapter 329-F1 of the Code of 1935, (Personal Net Income Tax) in so far as it applies to this case, provides as follows:

> "6943-f5. Tax imposed. A tax is hereby imposed, beginning the first day of January, 1934, upon every resident of the state, which tax shall be levied, collected

and paid annually upon and with respect to his entire taxable income as herein defined at rates as follows:

6943-f7. 'Net income' defined. The term 'net income' means the gross income of the taxpayer less the deductions allowed by this division.

6943-f8. 'Gross income' defined—exceptions.

1. The term 'gross income' includes gains, profits and incomes derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or re-occurring profits and income growing out of the ownership or use of or interest in property, real or personal; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit; or gains or profits, and income derived from any source whatever and in whatever form paid. The amount of all such items shall be included in the gross income of the tax year in which received by the taxpayer, unless, under the methods of accounting permitted under this division, any such amounts are to be properly accounted for as of a different period.

2. The term 'gross income' does not include the following items, which shall be exempted from taxation under this division:

(d). Interest upon the obligations of the United States or its possessions, agencies, or instrumentalities, which is or shall be exempt from state taxation by federal law.

(e). Salaries, wages, pensions and other compensation received from the United States by officials, employees or veterans thereof which are or shall be exempt from state taxation by federal law."

The appellants were engaged in farming and looking after their investments. (R. 20.)

There is no disagreement as to the amount of the tax, if any, but merely as to the validity.

SUMMARY OF THE ARGUMENT.

1. The statutory exemption from taxation is not contractual, and therefore not protected by the federal constitution.

a. In order that a state may be bound by a statutory exemption from taxation there must be a binding contract supported by consideration.

b. A mere gratuity or bounty does not amount to a contract.

c. A general statutory exemption from taxation is construed to be a gratuity, and not a contract.

d. There was no consideration for the exemptions of the bonds held by plaintiff, hence there was no contract.

2. There is no presumption that state, county and municipal bonds are exempt from taxation.

3. The statutes under which the exemptions are claimed by appellants apply only to *general property taxes*, and not to an excise tax.

a. The exemption statute had been construed by the Supreme Court of Iowa to apply only to general property taxes, prior to the time it was amended to include municipal, county, state and school bonds.

b. Therefore, the legislature knew that it was amending a statute which exempted only from general property taxes.

4. A general income tax, such as contained in Chap. 329-F1 of Code of 1935 is not a property tax but an excise tax.

a. Income is not property.

b. The Iowa Supreme Court has so held.

5. *People* v. *Gilchrist*, 262 U. S. 84; 64 L. ed. 883, is authority for the proposition that the Iowa income tax statute does not violate the contract clause of the federal constitution.

6. Cases on which appellants rely, as holding that to tax the interest is to tax the bonds, are not authority for the questions involved in this case.

a. Most of those cases deal with the power of the state to tax the federal government or its instrumentalities.

b. Not one of them deals with the right of a state to tax its own citizens, under a general income tax statute.

7. *Macallen* v. *Massachusetts*, 279 U. S. 620, is not applicable.

a. The exemption statute there involved exempted persons as well as property.

b. The taxing statute, by amendment was aimed directly at interest from the tax-exempt bonds.

c. The Massachusetts taxing statute construed in the *Macallen* case did not impose a general income tax, but applied only to domestic business corporations.

8. The Iowa income tax is not aimed at interest from tax free bonds. It is a tax on the recipient of the income measured by his income from all sources.

ARGUMENT.

The Exemption Was Not Contractual.

Appellants argue that the exemptions contained in Section 1304 of the Code of 1897, continuing through the Code of 1907 as amended, and now appearing as Section 6944 (5) of the Code of 1935, pertaining to municipal, school, drainage, county and state bonds, as well as Section 6944 (22) and Section 4753-a13, are contractual. They insist that when the bonds were issued the statutes then in force with reference to exemptions became a part of a statutory contract under which the bonds were issued and purchased. We do not believe it is necessary for this Court to determine whether or not the exemption is contractual, as will be shown later in this argument. We say, however, that we cannot agree with statement of appellants' counsel.

In their argument counsel for appellants cite and rely upon the decision in *Pacific Railroad Company* v. *McQuire*, 20 Wall, 36; 22 L. Ed. 282. It should be noted that that case did not involve the repeal of a prior general statute exempting the property from taxation; but rather involved an exemption from taxation contained in the charter of the company. The exemption was granted by the Act of the legislature organizing the company and under which the charter was issued. Under the decisions of the Supreme Court of the United States, as well as the Courts of the different states of the Union, a distinction has been recognized between an exemption from taxation which is in the nature of a gratuity provided by statute, and an exemption based on a valid consideration, and contained in the charter of a corporation. The Courts have generally held that where the legislature in granting the charter to a corporation, for the purpose of

inducing it to enter business in the state or to build a railroad, exempts such property from taxation for a certain period of time, the provisions of the charter are in the nature of a contract, and a subsequent statute taxing that property violates the obligation of the contract. On the other hand the Courts have held, and almost unanimously, that a statute which grants a gratuity or bounty in the nature of an exemption, for the purpose of inducing corporations to enter into a certain business, does not constitute a contract between the state and the property owner. That such a statute exempting property from taxation may be repealed at the will of the legislature is generally agreed.

In *East Saginaw Salt Mfg. Co.* v. *City of East Saginaw*, 13 Wall. 373; 20 L. Ed. 611, there was involved the constitutionality of a statute of the State of Michigan repealing a former act of the legislature of that state which provided in substance that all companies or corporations formed or that may be formed for the purpose of boring for and manufacturing salt should be entitled to have all their property, real and personal, used for the purposes mentioned in the act, exempt from taxation for any purpose. The act also provided for the payment of a bounty of ten cents for each and every bushel of salt manufactured by any individual, company or corporation, from water obtained from boring in the State of Michigan. It was argued on behalf of the salt company that the prior act held out an inducement or offer to induce parties to embark in the business of manufacturing salt in Michigan, and when such parties did subsequently engage in that business, and actually produce and manufacture salt, the act became a contract between the state and such parties, which a subsequent legislature could not constitutionally revoke or repeal.

The Supreme Court of the United States, after stating that it was within the power of the legislature to make a

valid contract exempting certain property from taxation, held that no such contract was created by the prior statute granting the exemption under consideration in that case. The Court said there was no consideration for the contract, and that there was no obligation on any person to comply with the conditions of the law. That it was purely voluntary on the one part and therefore purely voluntary on the other part; that is, on the part of the legislature, to continue, or not to continue the law.

The Court further stated that the case differs entirely from the case of a charter granted to a private corporation. That in the case of a charter granted, powers and privileges are conferred by the state, and corresponding duties and obligations are assumed by the corporation. And that if no right to alter or repeal is reserved, stipulations as to taxation, or as to any other matter within the power of the legislature, are binding on both parties.

The Court then went on to say that the Act of the legislature there under consideration could not be interpreted on that principle. That the Act was in its nature a general law, regulative of the internal economy of the state. That it merely granted a gratuity or bounty, and was therefore repealable at the desire or will of the legislature.

Again in *Grand Lodge of the State of Louisiana* v. *City of New Orleans,* 166 U. S., 143; 41 L. ed., 951, the United States Supreme Court considered the constitutionality of a provision of the Constitution of Louisiana. There a prior act of the legislature had exempted a certain building (naming it in the act) owned by the Grand Lodge from taxation so long as it was occupied by the Grand Lodge. Subsequent to the enactment of that statute a new constitution was adopted by the state containing a provision exempting from taxation property of charitable institutions, provided the

property so exempted was not used or leased for purposes of private or corporate profit or income. The Supreme Court of the United States held that there was no consideration for the original enactment of the legislature exempting the entire building from taxation. That it was a mere offer of bounty or a gratuity, and notwithstanding the recipients of such gratuity or bounty may have incurred expense upon the faith of the offer, the state is not bound thereby, and a subsequent legislature might constitutionally repeal such exemption.

Again in *Wisconsin and Michigan Railway Co.* v. *Powers*, 191 U. S., 379; 48 L. ed., 229, there was involved the constitutionality of an act of the State of Michigan repealing an exemption from taxation granted to the railway company by a prior act of that state, on the ground that it impaired the obligation of a statutory contract. The alleged contract levied a tax upon railroads, but provided "that the rate of taxation fixed by this Act or any other law of this state shall not apply to any railway company hereafter building and operating a line of railroad within this state north of parallel 44 of latitude, until the same has been operated for the full period of ten years, unless the gross earnings shall equal $4,000.00 per mile," etc. The railroad company later built a road north of the line designated by the statute, and its gross earnings had never equaled $4,000.00 per mile, so that it would be entitled to the exemption if the earlier statute had not been repealed. The contention of the company was that a later act of the legislature, repealing the exemption above quoted, impaired the obligation of a statutory contract, and thus violated Article I, Section 10, of the Constitution of the United States.

The United States Supreme Court again held the repealing statute to be valid. In passing upon the question, the Court made this pronouncement:

"In the case at bar, of course the building and operating of the railroad was a sufficient detriment or change of position to constitute a consideration if the other elements were present. But the other elements are that the promise and the detriment are the conventional inducements each for the other. No matter what the actual motive may have been, by the express or implied terms of the supposed contract, the promise and the consideration must purport to be the motive each for the other, in whole or at least in part. It is not enough that the promise induces the detriment or that the detriment induces the promise, if the other half is wanting. If we are to deal with this proviso in a general tax law as we should deal with an alleged simple contract, while, no doubt, in some cases between private persons the above distinctions have not been kept very sharply in mind (*Martin* v. *Meles*, 179 Mass., 114, 117; 60 N. E., 397), it is clear that we should require an adequate expression of an actual intent on the part of the state to set change of position against promise before we hold that it has parted with a great attribute of sovereignty beyond the right of change."

And in *Shiner* v. *Jacobs*, 62 Iowa, 392; 17 N. W., 613, the Court was called upon to consider the constitutionality of an Act of the legislature of this statute which reduced or altered the exemption from taxation of forest trees or timber exempted under a prior statute. The plaintiff contended that after the passage of the prior act, he had planted some forty-seven acres of forest trees, complying with the provisions of the act as to the manner of planting and the manner of cultivating. The later act, he contended, was unconstitutional because it altered the amount or extent of the exemption granted by the prior act which was held out to him as an inducement to plant forest trees. The Supreme Court of Iowa said the exemption provided was an act of general legislation, and applicable to all prairie land in the state. That every owner of land was thereby invited to devote a part of his land to the culture of forest trees. That

the law was not in the nature of a contract between the state and such land owners as availed themselves of its provisions, but more in the nature of a inducement or a gratuity. The Court said it had long been well settled that where an exemption from taxation is provided by the general laws of the state, any subsequent legislature may alter or remove the exemption. The Court also cited and quoted from as authority, the case of *Salt Company* v. *East Saginaw, supra.*

In *Miller* v. *Hagemann,* 114 Iowa, 195; 86 N. W., 281, an Act of the legislature provided that in all cities existing under special charter, having a population of more than 10,000, whenever any real estate may by ordinance be assessed with any special tax for the improvements of streets, then such real estate, so specially assessed, and the special assessment upon which shall be paid, shall after such payment be exempted from taxation for general road or street tax which might thereafter be assessed against it. The City of Davenport enacted an ordinance providing for an exemption authorized by the state statute. Later the legislature repealed its act authorizing the exemption. The plaintiff then commenced an action in mandamus to compel the defendant, Treasurer of the City of Davenport, to give him credit for, and mark as discharged, a charge for district road taxes in that city. Plaintiff contended that the repealing statute was unconstitutional because it impaired the obligation of a contract created by the prior Act of the legislature, and the City Ordinance passed pursuant thereto.

The Supreme Court of Iowa in holding that there was no impairment of the obligation of a contract by the enactment of the repealing statute, said:

> "The power of taxation is one of the sovereign and necessary powers of government, and, although it has finally been settled, after much contention, that this power may be limited by the granting of exemptions

which will, under the provisions of the federal constitution prohibiting the impairment of contracts, be irrepealable if provided for in a valid contract made by the state,—as, for instance, where they are given as an incident to a grant of land upon a consideration, or are embodied in a charter contract—yet the presumption is against any such surrender of the power of the state, and the exemption will be deemed repealable unless it clearly appears not only that the exemption is one which might be granted under the power of the state to contract, but also that it was clearly intended to be made irrepealable. This position is tersely stated in *Bank* v. *Billings*, 4 Pet., 514, 561; 7 L. Ed., 939, 955, as follows: 'That the taxing power is of vital importance, that it is essential to the existence of government, are truths which it cannot be necessary to affirm. It would seem that the relinquishment of such a power is never to be assumed. We will not say that a state may not relinquish it; that a consideration sufficiently valuable to induce a partial release of it may not exist; but, as the whole community has a right to insist that its abandonment ought not to be presumed in a case in which the deliberate purpose of the state to abandon it does not appear'."

Further in the opinion the Court, in citing many authorities including *East Saginaw Salt Co.* v. *City of East Saginaw*, *supra*, and *Grand Lodge of Louisiana* v. *New Orleans*, *supra*, said:

> "It is well settled that a general exemption from taxation, not embodied in a contract, is repealable, *even though property has been acquired or expenses incurred in reliance thereon.* Such an exemption is in the nature of a bounty, and not a contract, and 'those who rely upon it must base their reliance upon the free and voluntary good faith of the legislature'."

What is the nature of the exemption granted by Section 6944 (5) and (22), and Section 4753-a13 of the Code of 1935? There was no consideration for the enactments of the exemptions therein contained. Those exemptions were

granted by the legislature as a mere gratuity or bounty. True it is that the appellants have invested their money in county, municipal, school, primary road and bonus bonds. Nevertheless, every one of these bonds, as shown by the record in this case, were selling at par or above at the time the case was tried in the lower Court. The appellants were not induced to invest their money in any particular business by any promise of the legislature that such statute would never be repealed. Nor was there anything contained in any of the statutes herein involved which could be construed as binding upon the State of Iowa.

This Court has often said that the power of taxation is one of the sovereign and necessary powers of government, and is inherent in the state. That its abandonment will never be presumed, in view of its vital importance and its necessity to the existence of government. There is nothing contained in the statutes here under consideration upon which this Court could say that the legislature intended to exempt such bonds from taxation for all time to come. Nor is there anything in the act upon which this Court could base a construction that the legislature intended to say to investors "If you will invest your money in the types of bonds stated in these statutes, the State of Iowa promises and agrees not to tax them." There is nothing in the act upon which such a promise or agreement could even be inferred or presumed to have been made by the legislature. All the legislature did was to grant an exemption to those types of bonds without any statement or explanation as to how the exemption was being granted. As stated in *Wisconsin and Michigan Railway Co.* v. *Powers, supra*, the legislature was not making a promise, but framing a scheme of public revenue. It announced its policy, and possibly opened a chance for benefits to those who purchased the types of bonds indicated in the various statutes, *but it did not address them, and therefore it made no promise to them.*

There Is no Presumption That State, County and Municipal Bonds Are Exempt From Taxation.

It is a well known rule followed generally by the Courts that the power to tax is not granted to the states by constitutional provision, but is inherent in the state, and that unless the constitution contains a limitation on the right of the legislature, its power to tax is not limited. This rule extends to the taxation of municipal bonds generally. The following authorities uphold the doctrine:

26 Ruling Case Law 334, Section 292.
State v. *Page*, 100 W. Va., 166; 130 S. E., 426; 40 A. L. R., 501.
State National Bank v. *City of Memphis*, 116 Tenn., 641; 94 S. W., 606; 7 L. R. A. (ns), 663.
Com. v. *Maury*, 82 Va., 883; 1 S. E., 185.
Stoddard v. *Corbin*, 94 Conn., 543; 109 Atl., 813.
Easton v. *Board of Review*, 183 Ill., 255; 55 N. E., 716.
Hall v. *Middlesex County Commissioners*, 10 Allen (Mass.), 100.
State v. *Woodrull*, 37 N. J. Law, 139.
British Commerce Life Ins. Co. v. *Commissioners of Taxes and Assessments*, 31 N. Y., 32.
People ex rel Niagara Fire Ins. Co. v. *Board of Commissioners of Taxes and Assessments*, 76 N. Y., 64.
Drainage Commissioners v. *C. A. Webb & Co.*, 160 No. Car., 594; 76 S. E., 552.
Com. v. *City of Philadelphia*, 27 Pa., 497.
Wilkes-Barre Deposit & Savings Bank v. *City of Wilkes-Barre*, 148 Pa., 601; 24 Atl., 111.

It is not necessary to quote from or state the facts in the cases just cited. The principle is fundamental.

The Statutes Under Which the Exemptions Are Claimed by Appellants Apply Only to General Property Tax.

It should be noted that Section 6944 of the Code of 1935 is made up of twenty-two subdivisions or paragraphs. Some

of these subdivisions have been part of the law of this State since the Code of 1851. That portion of the section exempting municipal, school, drainage or levee districts and county bonds or certificates from taxation was enacted by House File 448 of the 33rd General Assembly, otherwise known as Chapter 81 of the Session Laws of 1909 and was approved on April 16, 1909, and became a part of the law of this State on July 4th of that year.

Subdivision 22 exempting soldiers bonus bonds issued pursuant to Chapter 332 of the Acts of the 39th General Assembly was enacted by that General Assembly. Prior to the adoption of either of these amendments, that is, the one exempting bonds of counties, municipalities and school districts, and the one exempting soldiers bonus bonds from taxation, the Supreme Court of Iowa had on several occasions held that Section 797 of the Code of 1873, which section has been carried forward as Section 1304 of the Code of 1897, and 1907, and now appears as Section 6944 of the Code of 1935, had reference only to general property taxes.

In the case of *Sioux City* v. *School District*, (1880) 55 Iowa, 150; 7 N. W., 488, it was held that the exemption contained in Section 797 of the Code of 1873 *applied to general property taxes* and not to a special tax such as an assessment for street improvements.

In the case of *Edwards & Walsh Construction Company* v. *Jasper County*, (1902) 117 Iowa, 305; 90 N. W., 1006, it was held that the provision of the statute which exempted the property of a county devoted entirely to public use did not apply to special assessment for street improvements, *but only to a general property tax.*

Again in *Iowa Mutual Tornado Ins. Assn.* v. *Gilbertson, State Treasurer, et al.*, (and seventeen other cases) (1906), 129 Iowa, 658; 106 N. W., 153, the Supreme Court of Iowa

said that the exemption from taxes of the property of religious, charitable and educational institutions granted under Section 1304 of the Code of 1897 (being the same as Section 6944 of the Code of 1935) did not grant an exemption from a business or license tax, *but only general property taxes.*

The above cited cases are only a few of those in which the Supreme Court of Iowa has said that what is now Section 6944 of the Code of 1935, applies only to property taxes.

After the decisions in the three cases just cited the legislature of Iowa amended Section 1304 of the Code of 1897 by inserting what is now subdivision (5) of Section 6944 of the Code of 1935, thereby granting an exemption to the bonds or certificates issued by municipalities, drainage districts, school districts and counties. Then at a later date the 39th General Assembly by Chapter 332, Section 10, by its Acts exempted Soldiers bonus bonds. Both of these General Assemblies when they exempted the bonds now mentioned in subsections 5 and 22 of Section 6944 of the Code of 1935, knew that the statute which they were amending had reference only to exemptions from property taxes, and did not include an exemption from any other class of taxes. It had been held prior to these amendments that the statute did not apply to special assessments or to privilege or license taxes, and in each decision it was clearly stated that the statute applied *only to general property taxes.* In view of the fact that the two General Assemblies, the 33rd and the 39th, knew that the statute applied only to general property taxes, it is conclusive that their intention was to exempt the bonds under consideration from general property taxes *and from no other tax.*

In *State of Iowa* v. *City of Des Moines, et al.,* (March 17, 1936) 266 N. W., 41 (not yet reported in Iowa reports), the Supreme Court of Iowa made the very latest pronouncement concerning Section 6944 of the Code of 1935, in which the

Court followed its prior holdings and said that Section 6944 has no application to an excise tax but only to a property tax.

The Iowa Supreme Court is not the only one that has passed on this question. Numerous other states have been called upon to determine whether or not a general constitutional or statutory provision exempting property of a state, county or municipal corporation, including bonds, from taxation, applies only to general property taxes, or whether it also applies to an excise tax. Quite generally the Courts have held that such a constitutional or statutory exemption applies only to general property taxes. Some of the cases which may be relied upon in support of the proposition are:

City of Portland v. *Kozer*, 108 Ore. 375; 217 Pac. 833.

Crockett v. *Salt Lake County*, 72 Utah 337; 270 Pac. 142.

Independent School District v. *Pfost*, 51 Idaho 240; 4 Pac. (2d) 893; 84 A. L. R. 820.

City of Ardmore v. *State of Oklahoma*, 32 Pac. (2d) 728.

Oregon v. *Preston*, 103 Ore. 631; 206 Pac. 304.

State v. *City of Sioux Falls*, 60 S. Dak. 330; 244 N. W. 365.

State v. *Board of Commissioners of Barton County, Kansas*, (1935) 51 Pac. (2d) 33.

The last group of cases cited deal more with exempting property of a county or state rather than bonds. However, it seems to us that the same rule applies.

In *Van Dyke* v. *Wisconsin Tax Commission*, (March 5, 1935) 217 Wis., 528; 259 N. W. 700, the Supreme Court of Wisconsin had before it practically the same question with which this Court is confronted. The question was whether or not interest from county road bonds was subject to an income tax. The statute under which the bonds were issued

became a law of Wisconsin on June 15, 1911. Section 1317M-12 provided as follows:

> "Any county, if its board shall so determine, may raise money for original improvement of any portion of the system of prospective highways *by issuing non-taxable*, four per cent, semi-annual interest payment bonds, running not more than ten years, and not exceeding with all other county indebtedness, the constitutional limit, the money to be expended in the respective towns in portions determined by the County Board according to Section 1317M-5; such bonds to be in such form as the State Highway Commission shall approve, and not to be sold at less than par * * *."

In 1919 sweeping changes were made in the highway laws and the section just quoted was repealed along with other laws, but was immediately re-enacted in Chapter 337 of the Acts of 1919. After the enactment of the Chapter 337 of the laws of 1911, the legislature enacted Chapter 516 exempting from taxation bonds issued by any county, town, city, village, school district, etc., in that state. Shortly after the enactment the legislature enacted Chapter 658 of the laws of 1911 providing for an income tax. The question then was whether or not the exemptions granted by Chapters 337 and 516 of the laws of 1911 was an exemption from property tax or from all taxes.

In passing on the question the Court made this statement:

> "It seems clear to us that at the time Chapter 337, Laws of 1911, was enacted, the only taxation to which such bonds could have been subjected was personal property taxation. Applying the reasoning here that was applied to the first contention relating to municipal bonds, and taking into consideration the fact that all of these acts were considered by the same Legislature, it seems clear that the Legislature, when it authorized the issuing by counties of nontaxable bonds, intended that such

bonds should be free from personal property taxation only. Had the income tax law not been subsequently enacted, no one would contend that Chapter 337 did anything more, or was intended to do anything more, than exempt such bonds from taxation as personal property."

A General Income Tax Law Such as Provided by Chapter 329-F1 of the Code of 1935 Imposes an Excise Tax Rather Than a General Tax on Property.

We do not believe it can be seriously urged by appellants that a general income tax imposes a tax on property. It may be, and we concede that the Courts have held that where a statute imposes a tax on the income from some one particular class of property, such as income from intangibles, it has been held to be a property tax. This view has been adopted not because income is considered as property, but because the statute in question in the particular case was directed at income from a particular class of property, rather than imposing a general income tax.

Generally speaking the Courts, in dealing with a statute which imposes a general income tax, have held that the tax was an excise rather than a property tax. They have also generally said that income is not property, and that the tax is not imposed on the property but on the recipient of the income, upon his right or ability to produce, create, receive and enjoy. The following authorities support this rule:

26 R. C. L. 142, Sec. 117.

Black on income and other federal tax, fourth addition, Sec. 2.

Cooley on taxation, Secs. 1743-51.

Bert Vilas v. *Iowa State Board of Assessment and Review*, (Iowa 1937) 273 N. W. 338.

Hale v. *Iowa State Board of Assessment and Review*, (Iowa 1937) 271 N. W. 168.

City of Dubuque v. *Northwestern Life Insurance Co.*, 29 Iowa 9.

Hattiesburg Grocery Co. v. *Robertson*, 126 Miss. 34; 88 So. 4; 25 A. L. R. 748.

Stanley v. *Gates*, 179 Ark. 886; 19 S. W. (2d) 1000.

Sims v. *Ahrens*, 167 Ark. 557; 271 S. W. 720.

Miles v. *Department of Treasury*, (Ind. 1935) 193 N. E. 855; 97 A. L. R. 1474.

Featherstone v. *Norman*, (Ga. 1930) 153 S. E. 58; 70 A. L. R. 449.

State ex rel Sallie F. Moon Co. v. *Wisconsin Tax Commission*, 166 Wis. 287; 163 N. W. 639.

Maxwell v. *Kent-Coffee Mfg. Co.*, 204 N. C. 365; 168 S. E. 397; 90 A. L. R. 476; affirmed without opinion 78 L. ed. 1040.

Huntoon v. *Commonwealth*, (Va.) 183 S. E. 783.

Cox v. *Sinclair Gulf Oil Co.*, 275 Mo. 339; 265 S. W. 196.

O'Connell v. *State Board of Equalization*, 95 Mont. 91; 25 P. (2d) 114.

In re Opinion of the Justices, 77 N. H. 611; 93 A. 311.

This list of authorities, headed by the three Iowa cases, two of them decided with reference to this specific statute, and the third decided years before an income tax was thought of in any state, all hold that income is not property. The case of *Vilas* v. *Iowa State Board of Assessment and Review*, *supra*, was decided in the spring of 1937. The Iowa Supreme Court in the opinion filed in that case relied on the authority furnished by the other cases cited under this division of the brief. The Court, also, in that opinion relied on the case of *City of Dubuque* v. *Northwestern Insurance Company*, which had been decided years before an income tax law was ever thought of in Iowa, and in which case the Iowa Supreme Court, in the early history of this state, said that income is not property.

If, as heretofore shown, the various Iowa statutes exempting from taxation the types of bonds here involved,

exempt them only from general property taxes, and, if a general income tax, such as we have in Iowa, does not impose a property tax, but an excise tax, then how can it be urged by counsel for appellants that the legislature imposed a tax upon these bonds, which it had agreed would not be imposed. Stating it in another way, if we should concede that the exemption statutes created a contract between the state and the holder of the bonds, that said bonds would not be taxed, we would still be compelled to say that the legislature, by the enactment of the income tax statutes, did not violate the contract, because it did not under the income tax law impose a property tax on the bonds.

People vs. Gilchrist, 262 U. S., 84; 67 L. ed., 883, Is Authority For the Proposition That Such a Statute Does Not Violate the Contract Clause of the Constitution of the United States.

This Court has in reality decided one case which, we believe, sustains appellee's contention. Although the question of interest from tax free state bonds was not involved, yet the legal proposition there raised and decided was analogous. In that case the question was whether or not the interest from certain bonds secured by mortgages was exempt from the income tax of New York State, because of the provision in the recording statute of that state, pursuant to which statute the mortgages were recorded that debts and obligations secured by such mortgages shall be exempt from other taxes by the state and local sub-divisions. This Court, in passing upon the question held that the interest was returnable for state income tax purposes, and that the mortgage recording statute granting the exemption, pertained only to a tax on the bonds, and not to an income tax, saying:

> "A tax upon the individual, measured by net income, might be regarded as one step removed from a tax on the capital from which the income was derived."

Counsel for appellants have attempted to make light of this decision insofar as its applicability to the instant case is concerned. Frankly, is there any difference between the proposition there stated and that for which we contend in the instant case? Does the mere fact that in the *Gilchrist* case bonds secured by mortgages were exempt from taxation make it any different from the instant case, in which the bonds involved are school, municipal and county bonds? Surely such a distinction would be splitting hairs.

We submit that the decision in *People* v. *Gilchrist, supra,* is decisive of the questions raised in this case, and that this Court will have only to rely on that case for its present authority.

Cases on Which Appellants Rely, as Holding That to Tax the Interest Is to Tax the Bonds, Are Not Authority For the Questions Here Involved.

Dawson v. *Kentucky Distilleries and Warehouse Co.,* 255 U. S. 288, involved the validity of a statute of Kentucky which provided for a tax on removal of whiskey to be shipped outside the state, or removed from bond. It was not for the privilege of engaging in business. It was not an income tax. It is inapplicable to the case at bar. There the Court said that it was a tax imposed upon each lot of whiskey at the time it was removed.

Evans v. *Gore,* 253 U. S. 245; 64 L. ed. 887, involved taxing a Federal District Judge on his salary under the federal income tax statute. The Constitution provided that Federal Judges salaries "shall not be diminished during their continuance in office". The Court said this was a limitation imposed in public interest and that the same government was diminishing the salary after it had agreed not to. The case is not in point with the proposition involved in the case at bar.

In *Gillespie* v. *Oklahoma*, 257 U. S. 501; 66 L. ed. 338, the state attempted to tax the instrumentality of the Federal Government. Courts have always said one government may not directly or indirectly burden the other. No question concerning the impairment of the obligation of a contract was involved.

Northwestern Mutual Life Ins. Co. v. *Wisconsin*, 275 U. S. 136; 72 L. ed. 202, is cited by appellant as holding that a state income tax on tax-exempt bonds is void as being a tax on the bonds. The tax there questioned was not an income tax but a 3% tax on the *gross receipts* of domestic insurance companies. The statute taxed every dollar of receipts—not merely net income. Compare this case with *Pacific Co.* v. *Johnson*, 285 U. S. 480, and *Educational Films Co.* v. *Ward*, 282 U. S. 379, where *net income* of a corporation was involved. This case also involved state taxing federal bonds. No question concerning contracts was involved. The statement quoted in *Northwestern Mutual Life Ins. Co.* v. *Wisconsin, supra*, that since *Gillespie* v. *Oklahoma*, 257 U. S. 501, the settled rule has been that where the principal is "absolutely immune" the interest is immune, has no application to interest from bonds exempted by the laws of the state where the bonds were issued.

National Life Ins. Co. v. *United States*, 277 U. S. 508; 72 L. ed. 968, is not in point. There the Federal statute imposed an income tax on corporations, but permitted deduction of interest from tax free bonds, both state and federal. It also permitted a deduction of a sum equal to 4% of the reserve diminished by the amount of interest from tax free bonds. The Court said that if the corporation was entitled to the 4% exemption, it was regardless of whether or not it had any interest from tax free bonds. The Court here found fault with the statute because it subjected one to

heavier burdens on his taxable property merely because he owned some tax free bonds. The statutes showed that it was directed squarely at tax free bonds.

Weston v. *Charleston*, 27 U. S., 449, is cited as authority for the proposition that a tax on the income from exempt securities is a tax on the securities. Appellants avoid mentioning that the securities there involved were United States bonds. The tax was levied by the City of Charleston on all United States bonds and other moneys and credits, as a property tax. This was not in any sense an income tax.

Willcuts v. *Bunn*, 282 U. S., 216; 75 L. Ed., 304, has no application. There the Federal statute exempted interest from state and municipal bonds. The question there was whether profits on sale of municipal bonds were taxable. The Court said yes. It might be noted that the statement made by the Court on the question of the reason for the implied constitutional provision, was that the implication was necessary to maintain our dual system of government. The Court said such taxation was a burden upon the borrowing power of the government whose instrumentalities were taxed by the other. But the question of taxing interest from tax-exempt securities was not under consideration.

In *Trotter* v. *Tennessee*, 290 U. S., 354; 78 L. ed., 358, appellant quotes from the opinion that a contractual exemption "must not be read so grudgingly as to thwart the purpose of the lawmakers." The case had better be cited on behalf of appellee. In the first place the case did not involve interest from tax free bonds, nor the contract clause of the Federal Constitution. In the second place, the exemption claimed was not allowed, the Court saying that because the Federal statute exempted compensation, insurance and maintenance and support paid by Federal Government to a veteran, the exemption could not be extended by construction to include real estate

purchased with the money received from the government by the guardian of the veteran.

Farrington v. *Tennessee*, 95 U. S., 679; 24 L. ed., 558, is not in point. The charter was issued to the Union Planters Bank under an act of the legislature which provided that in lieu of all other taxes it should pay an annual tax of one-half of 1% on its capital stock. Later the state and county imposed general taxes against the one hundred fifty shares owned by plaintiff. In that case we find a plain example of a contract created by the legislature in the provision of the charter. The legislature did more than merely grant an exemption. It agreed not to tax otherwise than as provided by the charter.

Coolidge v. *Long*, 282 U. S., 582; 75 L. ed., 562, is not in point. Here was involved the taxation, for inheritance tax purposes in Massachusetts, of property which had been transferred by trust deeds, long before the statute was enacted. The Court said the deeds were contracts fully executed before the law took effect.

Macallen vs. Massachusetts Is Not Applicable to the Facts In the Case at Bar.

Appellants place much reliance on the opinion of this Court expressed in *Macallen* v. *Massachusetts*, 279 U. S., 620; 73 L. ed., 874. There are some very noticeable distinctions between the *Macallen* case and the present case. In the first place, as stated by the trial court, as well as the Iowa Supreme Court (R. 25), the Massachusetts statute creating the exemption involved in the *Macallen* case is headed, "*Persons and Property* exempt from *Taxation*." The statute then reads: "Section 5. The following property and *polls* shall be exempt from taxation." That statute exempted not only property but persons. The Iowa statute exempts only property. And be-

fore it was amended to include bonds it had been construed to exempt only from a property tax.

Again, the Massachusetts taxing statute construed in the *Macallen* case, is not a general income tax statute but applies solely to domestic business corporations.

Furthermore, under the Massachusetts statute, as originally passed, income from tax exempt securities was exempted from the tax. By amendment the legislature removed the exemption. The result of this amendment was to impose a tax on this interest alone. It was aimed directly at the tax free bonds. It was not a case of taxing all income, including that.

If this reasoning is not correct, then how is it possible to reconcile the opinion in the *Macallen* case with that in the case of *New York* v. *Gilchrist, supra.*

It is true that the *Macallen* case is often cited for the proposition that interest from tax free securities cannot be included in the gross income of a corporation under a statute imposing a franchise tax on a corporation, measured by its net income. That this was never the intention of the Court in the *Macallen* case is definitely and convincingly shown by a reading of the opinions in *Pacific Company* v. *Johnson,* 285 U. S., 480, and *Educational Films Corp.* v. *Ward,* 282 U. S., 379. It is therefore definitely certain that what the Court did in the *Macallen* case was to say that because the legislature was attempting under the amended statute to reach one particular class of income, that is interest from tax free securities, and that alone, it was a tax on the income, rather than on the corporation, and hence nullified the statute.

The Iowa Income Tax Statute Is Not Aimed at Interest From Tax Exempt Bonds.

There is nothing in the Iowa statute which would indicate that the legislature was aiming at the interest from tax exempt securities. In fact the statute shows that the legislaure was not attempting to tax, as property, interest from tax exempt bonds. The statute shows plainly that the tax is imposed upon every resident of the state with respect to his entire net or taxable income. The "net income" means the gross income of the taxpayer less the deductions allowed by law. "Gross income" is then defined to include gains, profits and incomes from salaries, wages or compensation for personal service of every kind and in whatever form paid, or from professions, vocations, trades, business, commerce and income growing out of the ownership or interest in real or personal property; also from interest, rents, dividends, securities, or the transaction of any business carried on for gain or profit; and income derived from any source whatever and in whatever form paid. Under the Iowa statute then, the taxpayer is not paying a tax on the interest from his municipal bonds. He is paying a tax which is measured by his income from all sources. If these plaintiffs invested all of their money in tax free securities, they cannot say that because of their particular investments the law is aimed particularly at the interest received by them.

Counsel for appellants insist on saying that their clients receive the income solely because of their ownership of the bonds, and that therefore a tax is imposed on the bonds. If such statement is correct then was not the tax in *Cohn* v. *Graves*, 81 L. ed., 409, a tax on the foreign real estate? Was not the tax involved in *Pacific Co.* v. *Johnson, supra*, a tax on the bonds? Was not the tax in *Educational Films Corporation* v. *Ward, supra*, a tax on the copyrights?

This Court answered the question in each of those three cases in the negative, just as we believe it will say that the tax imposed on appellants in this case, as recipients of income, is not imposed because of their ownership of the bonds, and is not a tax on the bonds. That on the other hand it is a tax imposed on the individual because of his ability to create, receive and enjoy.

In *Cohn* v. *Graves, supra*, this Court, explaining the distinction between an income tax and a property tax, said:

> "The two taxes are measured by different standards, the one by the amount of income received over a period of time, the other by the value of the property at a particular date."

CONCLUSION.

In conclusion we suggest that we know of no better argument than contained in the opinion and decree of the trial court. That ruling was adopted in its completeness by the Supreme Court of Iowa. (R. 20.) It is the third time in the history of the state that its Supreme Court has adopted and set out in its opinion, the ruling of the trial court. The ruling of the trial court shows on its face that it was prepared after much serious thought. We believe this Court will agree with us that the Supreme Court of Iowa did not err in adopting it.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 16.—October Term, 1937.

Henry O. Hale and Elizabeth C. Hale, Appellants, *vs.* The Iowa State Board of Assessment and Review. } Appeal from the Supreme Court of the State of Iowa.

[November 8, 1937.]

Mr. Justice Cardozo delivered the opinion of the Court.

The question is whether interest upon bonds of the state of Iowa or its political subdivisions may be included in the assessment of a tax on the net income of the owners without detracting from earlier exemptions in respect of taxes upon property and without an unconstitutional impairment of the obligation of contract.

Appellants, residents of Iowa, were the owners in 1934 and afterwards of Iowa School District bonds, Iowa Road bonds, Iowa County bonds, and an Iowa Soldiers' Bonus bond, of the face value, aside from interest, of $752,900. The statutes of the state in force when the bonds were issued and when the appellants acquired ownership provide in varying but equivalent terms that such bonds "are not to be taxed",[1] "shall not be taxed",[2] or "shall be exempt from taxation."[3] Iowa was without an income tax when these exemptions were declared. A "Personal Net Income Tax" upon persons resident within the state was imposed for the first time by a statute enacted in 1934. Code 1935, sec. 6943-f4 *et seq.* In the assessment of that tax for 1935 interest on appellants' bonds in the sum of $36,893.75 was included by the State Board of Assessment

[1] "The following classes of property are not to be taxed: 1. The property of the United States and this state. . . . municipal, school, and drainage bonds or certificates hereafter issued by any municipality, school district, drainage district or county within the state." Iowa Code Supplement of 1915, sec. 1304, subd. 1; Code 1935, sec. 6944, subd. 5.

[2] "Bonds and road certificates . . . shall not be taxed". Acts 38th G. A. c. 237, sec. 28; Code 1935, sec. 4753-a13

[3] "All bonds issued hereunder [the Soldiers' Bonus Act] shall be exempt from taxation". Acts 39th G. A. c. 332, sec. 10; Code 1935, sec. 6944, subd. 22.

and Review against appellants' protest that the law, if so applied, impaired the obligation of contracts of exemption. Constitution of the United States, Article I, Sec. 10. By appropriate proceedings the controversy was brought to the Supreme Court of Iowa, where the assessment was upheld. 271 N. W. 168. The court assumed, without deciding, that the statutes of exemption should be treated as giving rise to contracts, and not merely as declarations of a legislative policy subject to revocation at the legislative pleasure. Proceeding on that assumption, the court interpreted the contracts as limited to taxes laid directly upon property in proportion to its value, and not as touching taxes in the nature of an excise upon the net income of an owner. This conclusion was supported by an analysis of the Iowa statutes and a review of Iowa decisions as well as the decisions of this and other courts. The case is here upon appeal. 28 U. S. C. § 344.

We make the same assumption that was made in the state court as to the existence of a contract, without indicating thereby how we would rule upon the point if a ruling were essential. Cf. *Clyde* v. *Gilchrist*, 262 U. S. 94, 98; *Pacific Co.* v. *Johnson*, 285 U. S. 480, 489; *Wisconsin & Michigan Ry. Co.* v. *Powers*, 191 U. S. 379, 386; *Dodge* v. *Board of Education of Chicago*, 302 U. S. —. Essential it is not for the decision of this case if the contract to be assumed is limited in scope and operation as it was limited below. Whether the limitation should be accepted is thus the pivotal inquiry. The power is ours, when the impairment of an obligation is urged against a law, to determine for ourselves the effect and meaning of the contract as well as its existence. *U. S. Mortgage Co.* v. *Matthews*, 293 U. S. 232, 236; *Funkhouser* v. *Preston Co.*, 290 U. S. 163, 167. Even so, we lean toward agreement with the courts of the state, and accept their judgment as to such matters unless manifestly wrong. *Phelps* v. *Board of Education*, 300 U. S. 319, 322, 323; *Violet Trapping Co.* v. *Grace*, 297 U. S. 119, 120; *Tampa Water Works* v. *Tampa*, 199 U. S. 241, 243, 244; *Dodge* v. *Board of Education of Chicago, supra.* For reasons to be developed, obvious error is not discernible in the ruling of the highest court of Iowa that the statutory exemptions invoked by the appellants were not intended to include taxes upon the net income derived from business or investments. To the contrary the decision has support in the statutory system of taxation viewed in its entirety, in state de-

cisions both in the courts of Iowa and elsewhere before the bonds were bought and afterwards, and even indeed in decisions of this court. Our search is for something more than the meaning of a property tax or an excise in the thought of skilled economists or masters of finance. It is for the meaning that at a particular time and place and in the setting of a particular statute might reasonably have acceptance by men of common understanding.

1. The limitation affixed to the contracts of exemption has support, first of all, in the statutory system of taxation considered as a whole.

Of the total interest ($36,893.75) collected on appellants' bonds, the greater portion ($32,776.25) is protected, if at all, by reason of the exemption given to bonds issued by any school district or county within the state. That exemption may best be studied as it stood in the Supplemental Code of 1915.[4] It was then subdivision 1 of section 1304. There were other subdivisions exempting other items:—the grounds and buildings for public libraries; household furniture up to a prescribed value; the farming utensils of any person who makes his livelihod by farming; and many other kinds of property. The section opens with the statement that "the following classes of property are not to be taxed", and then enumerates the classes. But the scope of the exemption is likely to be exaggerated unless the next preceding section (1303) is read at the same time. "The board of supervisers of each county shall annually, at its September session, levy the following taxes upon the assessed value of the taxable property in the county", a mandate clearly addressed to the levy of *ad valorem* taxes only. The inference is a fair one that section 1304 did not exempt the items there enumerated from taxation of every form and for every purpose. It withdrew them from the operation of the levy commanded by the section next preceding.[5] True, in later compilations of the stat-

[4] Compare Code of 1851, sec. 455; Code of 1873, sec. 797; Code of 1897, sec. 1304.

[5] An earlier form of the same statute, after providing, like the later one, that "the following classes of property are not to be taxed," adds the significant words, "and they may be omitted from the assessments herein required". Code of 1873, sec. 797. The opinion in Sioux City *v.* Independent School District, 55 Ia. 150, 151, 152, refers to these words as emphasizing the conclusion that exemption relates to taxes on the value of the property. The 1851 Code provision is almost identical.

utes, the sections have been rearranged, though with substance unaffected. Cf. Code, 1935, sec. 6953. In the Code of 1935, subdivision 1 of section 1304 is subdivision 5 of section 6944; section 1303 is section 7171. There can be little doubt that the meaning remains what it was before. *United States* v. *Ryder,* 110 U. S. 729, 740; *United States* v. *Sischo,* 262 U. S. 165, 168, 169; *Warner* v. *Goltra,* 293 U. S. 155, 161; *Davis* v. *Davis,* 75 N. Y. 221, 225, 226; *Fifth Avenue Bldg. Co.* v. *Kernochan,* 221 N. Y. 370, 375; *Mitchell* v. *Simpson,* L. R. 25 Q. B. D. 183, 189.

Besides the school and county bonds, appellants were the owners of a Soldiers' Bonus bond in the sum of $1,000, and Road bonds or certificates to the amount of $82,000. The exemption of the Bonus bond was declared by the statute authorizing the issue. 39th G. A., c. 332, sec. 10, adopted March 23, 1921. The exemption is now subdivision 22 of section 6944 of the Code of 1935, and should be given the same meaning as the exemption conferred by the other subdivisions. The Road bonds or certificates have their exemption under a different statute (sec. 4753-a13, Codes of 1931 and 1935), but the bonds are expressly declared to be obligations of the county (sec. 4753-a14), and, as the court below observed, there is no reason to suppose that the exemption given them was broader than that of county obligations generally.

2. The meaning of the Iowa statutes is clarified, if otherwise uncertain, by the opinions of the Iowa court in this and other cases.

The court in its opinion in this case applied the general principle that contracts of tax exemption must receive a strict consruction. The teaching of this court has been always to the same effect. "Grants of immunity from taxation in derogation of a sovereign power of the state, are strictly construed." *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491, citing many cases. Adhering to that principle, the Iowa court held that the tax exemption was limited to taxes upon property, and could not be extended to taxes in the nature of an excise. For this restriction it found support in its own earlier decisions, rendered many years before appellants' bonds were purchased. Thus, *Sioux City* v. *Independent School District,* 55 Ia. 150, decided in 1880, and *E. & W. Construction Co.* v. *Jasper County,* 117 Ia. 365, decided in 1902, held the exemption inapplicable to special assessments, limiting it at the same time "to the taxes contem-

plated in title 6 of the Code."[6] So also *Insurance Ass'n* v. *Gilbertson*, 129 Ia. 658, decided in 1906, interpreting a different subdivision of the exemption statute, but a cognate one, again limited the exemption to taxes upon property, and refused to apply it to an excise or license tax measured by receipts. The ruling was reiterated in *State* v. *City of Des Moines*, 221 Ia. 642, decided in 1936, upon facts not greatly different. Cf. *Plummer* v. *Coler*, 178 U. S. 115. From these precedents the Iowa court advanced to the holding, announced in the case at bar, that a tax upon net income was substantially an excise, and hence did not come within the scope of an exemption confined to taxes upon property. The result was conceived to be latent in the precedents if effect was to be given to their fair implications. "So the state court has told us", construing its own decisions, "and the good faith of its declaration is not successfully impeached." *Stockholders* v. *Sterling*, 300 U. S. 175, 183.

3. The ruling that a tax upon net income is without the scope of the exemption cannot be adjudged unreasonable, for it will be found to be supported by decisions in many other states, and even, indeed, by decisions of this court.

(a) The question as to the nature of such a tax has come up repeatedly under state constitutions requiring taxes upon property to be equal and uniform, or imposing similar restrictions. Many, perhaps most, courts hold that a net income tax is to be classified as an excise.[7] "The tax levied on income is not a property tax, but is a percentage laid on the amount which a man receives, irrespective of whether he spends it, wastes it, or invests it." *Featherstone* v. *Norman*, 170 Ga. 370, 382; *Purnell* v. *Page*, 133 N. C. 125, 129. As early as 1870, the Supreme Court of Iowa had written an opinion which foreshadows the same thought. *Dubuque* v. *Northwestern Life Ins. Co.*, 29 Ia. 9. Cf. *Vilas* v. *Iowa State Board of Assessment and Review*, 273 N. W. 338. True, there are courts in other

[6] The Code in force at that time was the one of 1873.

[7] Sims *v.* Ahrens, 167 Ark. 557; Stanley *v.* Gates, 179 Ark. 886; Waring *v.* Savannah, 60 Ga. 93, 100; Featherstone *v.* Norman, 170 Ga 370, 379; Diefendorf *v.* Gallet, 51 Idaho 619, 627; Miles *v.* Department of Treasury, 199 N. E. 372 (Ind.); Opinion of the Justices, 133 Me. 525, 528; Hattiesburg Grocery Co. *v.* Robertson, 126 Miss. 34, 52; Ludlow-Saylor Wire Co. *v.* Wollbrinck, 275 Mo. 339, 351; Bacon *v.* Ranson, 331 Mo. 985, 990; O'Connell *v.* State Board of Equaliation, 95 Mont. 91, 112; Mills *v.* State Board of Equalization, 97 Mont. 13, 17; Maxwell, Commissioner *v.* Kent-Coffey Mfg. Co., 204 N. C. 365, 371; Hunton *v.* Commonwealth, 166 Va. 229, 243; Appeal of Van Dyke, 217 Wis. 528, 535; 4 Cooley on Taxation, 4th ed., sec. 1743. Many cases are collected in Brown, *The nature of the Income Tax*, 17 Minn. L. Rev. 127, 130, 139.

states that teach a different doctrine.[8] Our duty does not call upon us to determine which view we would accept as supported by the better reason if the choice were an original one for us, unaffected by the view accepted in the court below. Enough for present purposes that with authority so nearly balanced the Iowa construction of the contract is at least not plainly wrong. The propriety of our keeping to it is the clearer when we bear in mind that there were Iowa decisions pointing the same way before appellants became owners.

(b) Finally, and even more conclusively, decisions of our own court forbid us to stigmatize as unreasonable the classification of a tax upon net income as something different from a property tax, if not substantially an excise. *Clyde* v. *Gilchrist*, 262 U. S. 94; *New York ex rel. Cohn* v. *Graves*, 300 U. S. 308; *Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S. 1, all point in that direction. We will consider them in the order stated.

The taxpayer in *Clyde* v. *Gilchrist* claimed the benefit of an exemption under a statute of New York to the effect that, upon payment of a recording tax, debts and obligations secured by mortgages of real property should be exempt from other taxation by the state and local subdivisions. The question was whether the exemption thus accorded was applicable to an income tax enacted long afterwards. The state court ruled against the taxpayer (*People ex rel. Central Union Trust Co.* v. *Wendell*, 197 App. Div. 131; *People ex rel. Clyde* v. *Wendell*, 197 App. Div. 913; 232 N. Y. 550), assuming the existence of a contract of exemption, but holding that it was not intended to apply to taxes upon income. This court, considering the fact that at the date of the exemption statute "no one thought of an income tax", and recalling that "any contract of exemption must be shown to have been indisputably within the intention of the Legislature", sustained the judgment of the state court. "The conclusion does not seem to us very difficult to reach". 262 U. S. at p. 98.

The controversy in *New York ex rel. Cohn* v. *Graves*, decided at the last term, evoked a ruling by this court that a state tax upon

[8] Eliasberg Bros. Mercantile Co. *v.* Grimes, 204 Ala. 492; Bachrach *v.* Nelson, 349 Ill. 579, 595; Opinion of the Justices, 220 Mass. 613, 624; 266 Mass. 583, 585; Harrison *v.* Commissioner of Corporations, 272 Mass. 422, 427; Redfield *v.* Fisher, 135 Ore. 180, 192; Kelley *v.* Kalodner, 320 Pa. St. 180, 185; Culliton *v.* Chase, 174 Wash. 363; Jensen *v.* Henneford, 185 Wash. 209, 216.

net income which included rents derived from land in another state, was not equivalent to a property tax imposed upon the land itself. "The incidence of a tax on income differs from that of a tax on property. Neither tax is dependent upon the possession by the taxpayer of the subject of the other. His income may be taxed, although he owns no property, and his property may be taxed although it produces no income." 300 U. S. at p. 314. *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601, was considered and distinguished. Two rulings emerge as a result of the analysis. By the teaching of the *Pollock* case an income tax on the rents of land (157 U. S. 429) or even on the fruits of other investments (158 U. S. 601) is an impost upon property within the section of the Constitution (Art. I, sec. 2, cl. 3) governing the apportionment of direct taxes among the states. 300 U. S. at p. 315. By the teaching of the same case an income tax, if made to cover the interest on government bonds, is a clog upon the borrowing power such as was condemned in *McCulloch* v. *Maryland*, 4 Wheat. 316, and *Collector* v. *Day*, 11 Wall. 113, 124. 300 U. S. at pp. 315, 316. There was no holding that the tax is a property one for every purpose or in every context. We look to all the facts.

In line with that conception of the *Pollock* case is *Brushaber* v. *Union Pacific R. R. Co., supra*, where the court pointed out (240 U. S. at pp. 16, 17) that "the conclusion reached in the Pollock Case did not in any degree involve holding that income taxes generically and necessarily came within the class of direct taxes on property", but that to the contrary such taxes were enforcible as excises except to the extent that violence might thus be done to the spirit and intent of the rule governing apportionment.

The doctrine of these decisions, we think, is applicable here. We do not overlook the argument that the promise to pay interest may be part of the obligation of a contract as much as the promise to pay principal. To concede this counts for little if the distinction between an excise and a property tax, or between the different meanings of a property tax, is not permitted to escape us. Unless the foregoing analysis is faulty, the tax complained of by appellants is not laid upon the obligation to pay the principal or interest created by the bonds, at all events within the meaning of the contract of exemption. The tax is laid upon the net results of a bundle or aggregate of occupations and investments. Under a

statute so conceived and framed a man may own a quantity of state and county bonds and pay no tax whatever. The returns from his occupation and investments are thrown into a pot, and after deducting payments for debts and expenses as well as other items, the amount of the net yield is the base on which his tax will be assessed. Cf. *United States Glue Co.* v. *Oak Creek,* 247 U. S. 321, 329. In the light of all the precedents brought together in this opinion, we cannot say that a tax assessed on such a base is a plain violation of any contract of exemption to be discovered in the laws of Iowa.

Doubtless a contract of exemption can be phrased in such terms as to forbid the imposition of a net income tax or indeed a tax of any sort. Bonds issued by the Government of the United States are sometimes exempt by their express terms from income taxes to any degree (40 Stat. 35, sec. 1), sometimes from income taxes other than surtaxes or excess profits taxes. 40 Stat. 288, 291, sec. 7. Such were the Liberty Bonds considered by this court in *Macallen Co.* v. *Massachusetts,* 279 U. S. 620. Broad also was the exemption given to the Federal Farm Loan bonds considered in the same case, at least in respect of taxes levied by the states, for the bonds were declared expressly to be federal instrumentalities. 39 Stat. 360, 380, sec. 26. Less clear and comprehensive was the exemption of the Massachusetts bonds declared by a Massachusetts statute (Mass. G. L. Chap. 59, sec. 5) and dealt with more or less summarily at the end of the opinion. 279 U. S. at p. 634. However, the courts of Massachusetts had already rejected the contention that an income tax was to be classified as an excise rather than a tax on property. *Opinion of the Justices,* 220 Mass. 613, 624; 266 Mass. 583, 585; *Harrison* v. *Commissioner of Corporations,* 272 Mass. 422, 427. The meaning of the exemption was properly ascertained in subjection to that ruling. Cf. *Educational Films Corp.* v. *Ward,* 282 U. S. 379, and *Pacific Co.* v. *Johnson, supra.*

Nothing in this opinion is at war with *Weston* v. *City Council of Charleston,* 2 Pet. 449, or other cases declaring the immunities of governmental agencies. In the case cited and its congeners the problem for decision was whether a tax upon income, even though not a property tax in strictness or for every purpose, was one in such a sense or in such a measure as to hamper the freedom of the central government through the interference of the states or the

freedom of the states through the interference of the central government. The limitations declared in those decisions were gathered by implication from the structure of our federal system, and were accommodated, as the court believed, to the public policy at stake. What the court is now concerned with, however, is not the preservation or protection of any governmental function. Iowa cannot be held to cripple in an unconstitutional way her own privileges and powers when she levies an income or even a property tax upon bonds issued by herself. The court is now concerned with the meaning and effect of particular contracts of exemption to be read narrowly and strictly. There is no room at such a time for the freer and broader methods that have been thought to be appropriate in the development of the doctrine of implied restraints.

The judgment is

Affirmed.

SUPREME COURT OF THE UNITED STATES.

No. 16.—October Term, 1937.

Henry O. Hale and Elizabeth C. Hale, Appellants, *vs.* The Iowa State Board of Assessment and Review. } Appeal from the Supreme Court of the State of Iowa.

[November 8, 1937.]

Mr. Justice Sutherland, dissenting.

I think the judgment should be reversed.

At the time the bonds here involved were purchased, the statutes of Iowa expressly provided that they "are not to be taxed" or "shall not be taxed" or "shall be exempt from taxation". These are plain words, and there is no room for construction. When the language is clear, it is conclusive. "There can be no construction where there is nothing to construe." This has been held so often by this court that it has become axiomatic. That the provisions with respect to the non-taxability of the bonds constitute a statutory contract with the purchaser of the bonds, and that any subsequent statute which violates these provisions impairs the obligation of the contract, is not a matter of dispute. The sole question is whether the imposition of an income tax in respect of the interest derived from the bonds is a tax upon the bonds.

We are not concerned with the name given to the tax. The exemption is in unqualified terms, and includes *all* taxes. And I see no warrant for saying that the exemption must be limited to so-called *ad valorem* taxes. The exemption is not in the form or nature of a proviso to the section fixing the time and providing for the levy of such taxes, but is a substantive enactment standing independently and complete in itself. Nor do I see any ground for confining it to taxes then known to the Iowa law. Such an all-embracing exemption cannot be avoided by the invention of a new tax. To me, it seems evident that if any tax be imposed upon the bonds, the contract is impaired. It likewise seems evident that the tax here is imposed on the bonds themselves.

Of what does a bond for the payment of money consist? Certainly not the principal alone; for the promise to pay interest is as much a part of the obligation of the bond as the promise to pay the principal. A bond, for example, promises to pay the bearer at the end of ten years the sum of $1,000, and also interest at the rate of 5% per annum, to be paid semi-annually; that is to say, promises to pay $25 at the end of every six-months' period, and $1,000 at the end of ten years. There is no difference between the two promises in respect of their binding or legal quality. Both are obligations of the bond. If one cannot be violated, neither can the other.

There is no difference in principle between such a bond and one where the bond is issued upon a discount basis, as in the case of United States Savings Bonds (Treasury Department Circular No. 529, February 25, 1935). A United States Savings Bond for $1,000, payable in ten years "without interest", may be purchased for the sum of $750—the remaining $250 being deferred interest. Plainly, the $250 deferred interest is as much a part of the bond as the $750 originally invested; and a contractual obligation exempting the bond from taxation is equally applicable to each. Is the case different if the bond shall provide for the payment of $750, together with interest in the sum of $250 to be paid in installments or at the end of ten years? Certainly not, unless form is to be exalted and substance ignored.

The force of what has been said cannot be avoided by merely calling the tax an excise. If a tax falls upon the bond and lessens its proceeds, either in respect of principal or interest, it is a tax on the bond, and cannot be made something else by resort to the vocabulary or by employing some circuitous method of imposing it. It is well settled, at least generally, that "what cannot be done directly . . . cannot be accomplished indirectly by legislation which accomplishes the same result." *Fairbank* v. *United States*, 181 U. S. 283, 294, 300, and cases cited. I am unable to subscribe to that philosophy which seems to teach that a forbidden result may nevertheless be achieved if only some delusive and devious way of achieving it can be found.

Mr. Justice McReynolds and Mr. Justice Butler join in this opinion.